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STATEMENT OF
WILLIAM J. GAINER, ASSOCIATE DIRECTOR
HUMAN RESOURCES DIVISION

BEFORE THE
SUBCOMMITTEE ON POSTSECONDARY EDUCATION
OF THE
COMMITTEE ON EDUCATION AND LABOR
UNITED STATES HOUSE OF REPRESENTATIVES
ON
THE DEPARTMENT OF EDUCATION'S ACTIONS TO
COLLECT DEFAULTED STUDENT LOANS

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here to discuss the General Accounting Office's review of the Department of Education's actions to collect defaulted student loans. Our evaluation was conducted pursuant to this Subcommittee's request that we study Education's use of private collection agencies to collect defaulted student loans under two loan programs--the Federal Insured Student Loan (FISL) and National Direct Student Loan (NDSL) programs. Through June 1984, these two programs have made an estimated 13.7 million loans totaling approximately \$16.8 billion to assist eligible postsecondary students. The Subcommittee asked us to

- determine the level of effort made by the Department and its contractors to collect defaulted loans;
- determine how often contractors settled for less than the full amount owed; and
- examine Education's litigation of defaulted loans, including the involvement of the Department of Justice.

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Our testimony today will focus on these matters for the two programs. We will also briefly discuss our related collections work on the Guaranteed Student Loan program, which is just beginning.

Overall, we found that the Department has increased its annual in-house and contract collections from \$52 million in fiscal year 1982 to \$86 million in fiscal year 1984 with fewer departmental staff available to carry out and oversee the collection function. In-house staffing fell from 517 to 373 during this period. Although the contract collectors have increased the Department's collections, they have been able to resolve (bring accounts into repayment or determine their uncollectability) only about 9 percent of assigned accounts because of a variety of problems. For example, nearly 70 percent of all defaulters could not be located. The Department is now in the process of awarding additional contracts with a variety of new provisions in an attempt to resolve those defaulted accounts still outstanding. A substantial portion (estimated at half a million accounts) of this defaulted loan portfolio will have to be resolved without the option of litigation by the Department of Justice. The age of the accounts exceeded the federal statute of limitations without needed action by the Department of Education.

BACKGROUND

The FISL and NDSL programs are two of the four student loan programs administered by the Department's Office of Student Financial Assistance. These two student aid programs provide low-cost loans to students pursuing a postsecondary education.

Under the FISL program, participating lending institutions make loans to student borrowers which are directly insured by the federal government. Borrowers repay the loans, including interest, directly to the lenders.

The NDSL program provides for Education to assist postsecondary institutions establish revolving funds to make loans. The federal government and the participating schools make yearly contributions to continue to make funds available to students. The schools collect loan repayments (principal and interest) and deposit them in the revolving fund so the money can be reloaned to other students.

As part of its effort in overseeing the FISL and NDSL programs, the Department of Education assumes responsibility for collecting these loans whenever a student defaults. The Department accepts defaulted loans after the schools and lending institutions which made the loans have followed certain procedures in attempting collection. As of March 30, 1985, the Department was responsible for collecting over 1 million FISL and NDSL defaulted loan accounts with a value (including principal and interest) of approximately \$1.4 billion.

In 1981, Education consolidated its loan collection activities from 10 regional offices to 3 (Atlanta, Chicago, and San Francisco) and awarded contracts to private collection agencies to supplement the 3 regional offices' defaulted loan collection activities. The Department believed that the collection agencies' efforts would be at least as cost effective as its own efforts. The three collection contracts awarded in November 1981 were for 3 years, although they were subsequently modified and extended until November 1986. The GC Services Corporation was awarded the contracts to operate in the Atlanta and Chicago regions, and the Payco American Corporation was awarded the San Francisco contract.

These contractors are to systematically collect the amounts due or determine the uncollectability of the accounts they receive. They are to do so in accordance with provisions in their contracts. The contracts are based on standards developed by the Department which outline the minimum collection activities to be performed. The standards also specify the documentation needed for various categories of accounts which are determined to be uncollectable due to the borrowers' bankruptcy, disability, or death. The contractors are paid a commission for the funds they collect.

DEPARTMENT OF EDUCATION COLLECTION EFFORTS

Since late in 1983 the Department has taken several steps to improve collections.

--It created an independent unit called the the Debt Collection and Management Assistance Service.

--It implemented an automated collection system to further facilitate its collection efforts.

--It established a write-off policy for loans which it deemed uncollectable, thereby allowing it to focus on those accounts which have the best potential for collection.

In addition, the Department started reporting debtors to credit bureaus in October 1984. According to Education collection officials, the Department is also (1) planning to begin offsetting loan amounts against the federal tax refunds of student loan defaulters in January 1986 and (2) considering participating in an IRS program in which debts written off by federal agencies, such as Education, can be added to the gross income of a taxpayer-debtor and taxed accordingly.

Prior to the recent changes which have been made in Education's collection system, we noted a variety of apparent problems with its in-house collection efforts. Based on our field work, we found that in fiscal year 1982 the Department

--had no record of any action being taken to collect on approximately 37 percent of all accounts, and of those accounts which received some collection effort roughly 30 percent were not worked within the first twelve months Education had the loan;

--made limited attempts to collect on loans other than sending computerized demand letters (an average of only three additional actions per year per account such as a phone call or an additional letter);

--did not prioritize loans to be worked based upon loan amount; and

--transferred a large number of loans to private collectors without any evidence that they had been worked by the Department (perhaps as many as 37 percent of all loans transferred).

Similar analysis performed in 1983 showed little overall change. The Department explained this by noting that the very large number of accounts per collector forced them to rely primarily on collections spurred by the computerized letters, while passing any labor intensive work on to the contractors.

Nonetheless, the Department did increase its total collections with fewer staff. For example, in fiscal year 1982, the Department collected about \$44 million with 517 staffmembers. In fiscal year 1984 collections increased to \$49 million while the number of staff decreased to 373. As of April 30, 1985, the Department had collected about \$24 million in fiscal year 1985.

Although we believe the Department's recent changes are positive steps in improving the collection process, it is too early to tell whether they will result in improved collections.

CONTRACTORS' COLLECTION EFFORTS

Once Education Department collectors have held the delinquent account for at least 120 days and been unsuccessful in getting borrowers to repay their loans, loans can be turned over to a private collection agency.

Contractors' resolution of accounts was hampered by a variety of problems. For example, based on our review of a sample of accounts Education assigned the contractors, we found that locating defaulters was a major problem. In Atlanta and

Chicago, GC Services' collectors could locate only about 27 percent of the defaulters, while in San Francisco, Payco made contact with only 39 percent of the defaulters. In addition, the method of compensation--which resulted in payment only when a collection was obtained--made contractors reluctant to expend funds to close accounts without a collection, thereby resulting in a large number of unresolved loans.

Our field work showed, however, that in certain respects the contractors kept better records, acted more quickly to attempt collection, and made greater efforts to collect. For example:

- the contractors expended some effort on nearly all accounts we sampled,
- for those accounts which received some effort, the initial contact or action was taken on all but 13 percent of accounts within the first six months after receipt, and
- the contractors initiated an average of 6 collection-related actions per account per year.

The contractors' efforts resulted in total collections of over \$65 million (net to Education after commissions of \$46 million) during the 3-year period ending September 30, 1984. Yet according to the Department, as of April 30, 1985, the contractors had resolved and returned only about 90,000 of the over 745,000 defaulted loans they were assigned. Of these 90,000, Education actually requested the return of 26,000 accounts, meaning that

about 9 percent of the loans they were assigned. This occurred for a variety of reasons including the age of the accounts, the fact that Education had already made some effort on the majority of the accounts, and that many addresses were not current.

Education hopes to award additional contracts to collect those FISL and NDSL accounts still outstanding, as well as any new accounts which Education may assign after attempting to make collections. The proposed new contracts contain more stringent performance requirements than the first group of contracts, are designed to assure that collectors try to resolve all accounts assigned, and provide incentives for high performance. They also allow for periodic evaluation and cancellation by Education for nonperformance by the contractor. (See attachment I.)

Education officials attribute their revision of contract provisions to experience gained under the current contracts.

REPAYMENT OF LOANS WITH
PARTIAL WRITE-OFF (COMPROMISES)

Both Education and contract collectors can, with the Department's approval, accept a partial payment in full satisfaction of a debt. We found that (1) the Department's policy regarding loan compromises has changed several times since it awarded the current collection contracts, and (2) the contractors obtain a compromise more frequently than the Department. Consequently, contractors who have an economic incentive to compromise have done so on more than eight times as many accounts

as Education (3,730 to 459) during the period October 1, 1982, through April 19, 1985. For the \$7.7 million of accounts the contractors made compromised settlements on, they collected \$5.7 million (74 percent), thereby forgiving \$2 million. Education staff, meanwhile, collected \$824,000 (82 percent) on \$1,002,000 of accounts, thereby forgiving \$178,000. The average amount forgiven per loan was \$388 for Department compromises and \$545 for contractor compromises.

The Department was unaware of these differences in the number of compromises made until we conducted our analysis. It has since instructed its departmental collection staff to attempt to make compromises more often as permitted by federal standards. Education officials told us that their regional offices were being somewhat "conservative" in compromising defaulted loans, although they had the same opportunity to compromise accounts as did the contractors.

LIMITED USE OF LITIGATION
TO COLLECT DEFAULTED LOANS

The Department of Justice is the agency charged with bringing civil actions against those who owe debts to the federal government. The federal statute of limitations, as amended (28 U.S.C. 2415), provides for a 6-year period in which legal collection action may be brought by the U.S. government to recover its debts. We found that a substantial portion of the Department of Education's defaulted student loan portfolio cannot be litigated because the time elapsed since borrowers defaulted on

their loans exceeded the federal statute of limitations. We estimate that as of March 1985, approximately 503,000 FISL and NDSL defaulted accounts, totaling \$666 million, were likely old enough to exceed the limitation and borrowers had never made payments on their loans.

The Departments of Education and Justice began a special project in October 1984 to expedite litigating defaulted student loans. At the time, the two departments agreed, at the Office of Management and Budget's urging, that Education should refer 50,000 cases to Justice by September 30, 1985. As of March 15, 1985, Education had transferred 12,128 cases to Justice. If Education continued to transfer cases to Justice at this rate, it would be below that needed to reach 50,000 cases by September 30. Education has since readjusted its estimate and hopes to refer approximately 16,200 cases by that date. The Department believes the original goal of 50,000 was very optimistic.

Proposed legislation to assist
Justice's litigation efforts

To assist Justice in its efforts to litigate defaulted student loans, as well as claims referred by other federal agencies, legislation was introduced in both Houses of the Congress to address the debt litigation problem. This proposed legislation would allow private attorneys, under contract with the U.S. Attorney General, to litigate debts owed to the federal government. In the Senate, S. 209 was introduced on January 21,

1985, and contains the same language used in S. 1668 which was passed by the Senate in 1984 (the 98th Congress). In the House of Representatives, a similar bill, H.R. 979, was introduced on February 6, 1985.

GAO supports the passage of this legislation. We believe that if properly supervised, the use of private counsel paid on a contingency basis could be a useful and profitable complement to the collection tools currently available to the government.

GUARANTEED STUDENT LOAN COLLECTIONS

We recently initiated a study of the collection of defaulted loans by guarantee agencies. Our work is still in the preliminary stages; thus, we have not yet reached any conclusions. Our approach will be to examine the entire area of guarantee agency collections by determining (1) how the agencies go about collecting these loans, (2) how procedures vary among the agencies and from those utilized by Education, and (3) how successful these procedures have been. We will also look at practices such as the use of collection agencies, credit bureaus, and litigation, and attempt to determine whether the agencies are adequately protecting the federal government's financial interests.

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Mr. Chairman, this concludes our statement. We will be happy to answer any questions at this time.